

A reorganized railroad company which has issued all of its first mortgage bonds and the majority of its shares of common stock to the Reconstruction Finance Corporation in satisfaction of a debt, and has also issued and set aside shares of its common stock for subscription through warrants issued to private creditors, is not exempt from Federal income taxes.

Advice has been requested whether the income of a reorganized railroad company is exempt from Federal income taxes under the following circumstances.

X railroad company, which emerged from proceedings for reorganization under section 77 of the Bankruptcy Act, issued all of its first mortgage bonds and approximately 75 percent of its authorized shares of common stock to the Reconstruction Finance Corporation (hereinafter referred to as R.F.C.) because of a claim arising from loans made by the R.F.C. to the trustee in bankruptcy of the railroad company. The railroad also issued warrants to private creditors for the purchase of the balance of the shares of common stock, which were issued and set aside for that purpose. The railroad company holds its charter from the State of M, and its primary purpose is the operation of a railroad, consisting of the hauling for hire of freight and passengers.

The question whether the exemption from all Federal taxes extended to the R.F.C. by act of Congress also extends to a business corporation, whose outstanding stock or obligations are owned by the R.F.C., must be determined not only from the statute respecting the R.F.C. and from the provisions of section 101 of the Internal Revenue Code of 1939 regarding nontaxable organizations, but also from certain conditions with respect to the purpose and control of the corporation.

The R.F.C. was made expressly exempt from all taxes imposed by the Federal Government, and this exemption was extended to any other public corporation wholly financed and wholly managed by the F.R.C. and to banks whose stock or obligations were acquired by the R.F.C. prior to July 1, 1947. Section 10, Reconstruction Finance Corporation Act, 47 Stat. 9, as amended, 15 U.S.C. 607. Section 104(14) of the 1939 Code provides that, in order for a corporation to be exempt from Federal income taxes, it must be organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the proceeds from such property, less expenses, to an organization which itself is exempt from the tax imposed by Chapter 1 of the 1939 Code. It may not operate a business. Section 101(15) of the 1939 Code provides that in order for a corporation to be exempt from Federal income taxes, it must have been chartered by an Act of Congress, be an instrumentality of the United States, and be exempt from Federal income taxes under its chartering act.

The other conditions which should be considered in

determining the taxability of a corporation controlled by a Federal agency, such as the R.F.C., are the domination and control arising from complete ownership of the corporate stock by the agency, whether the subsidiary corporation's existence is being maintained for a limited time and for the specific purpose of liquidation, the purpose underlying the creation of the agency and the broad tax exemption accorded it by Congress, and whether the subsidiary corporation represents an asset of the agency from which a partial recoupment of its investment can be effected.

In the instant case, the company was not organized by the R.F.C., neither was it organized for the purpose of holding title to property for the benefit of a tax-exempt stockholder as required by section 101(14) of the 1939 Code; nor was it chartered by an Act of Congress, as an instrumentality of the United States, as required by section 101(15) of the 1939 Code. There is no question of liquidation since, according to the plan of reorganization, warrants in the hands of certain classes of private creditors for the purchase of common stock indicate a continuation of the railroad company with a view to eventual private ownership of the stock. Furthermore, in view of the holders of the stock warrants, it cannot be said that the R.F.C. has complete legal and beneficial ownership of the corporation.

Accordingly, in view of the foregoing facts, it is held that a reorganized railroad company, which has issued all of its first mortgage bonds and the majority of its shares of common stock to the Reconstruction Finance Corporation in satisfaction of a debt, and has also issued and set aside shares of its common stock for subscription through warrants issued to private creditors, is not exempt from Federal income taxes.